

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY)
UTILITIES COMPANY REGARDING)
THE TRANSFER OF ANY REAL)
PROPERTY ASSOCIATED WITH) CASE NO. 2005-00405
THE LOCK NO. 7 HYDROELECTRIC)
PROJECT, PROJECT NO. 539)
TO LOCK 7 HYDRO PARTNERS, LLC)

O R D E R

Kentucky Utilities Company (“KU”) has applied for authority to transfer any real property associated with KU’s Lock No. 7 Hydroelectric Project, Project No. 539 (“Lock No. 7 Project”) to Lock 7 Hydro Partners, LLC (“Lock 7 Partners”).¹ Finding that the proposed transfer is not inconsistent with the public interest, we grant the application.

PARTIES TO THE TRANSACTION

KU is a corporation organized under KRS Chapter 271B that owns and operates facilities that generate, transmit, distribute, and sell electricity to approximately 484,896

¹ The Commission has previously directed KU to “seek Commission approval prior to entering into a sale or lease of any land located on any existing generation sites.” See Case No. 2002-00029, Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Acquisition of Two Combustion Turbines (Ky.PSC June 11, 2002) at 8.

customers in all or portions of 77 counties in Kentucky.² Accordingly, it is a utility subject to Commission jurisdiction and a retail electric supplier.³

Lock 7 Partners is a limited liability company organized pursuant to KRS Chapter 275. Salt River Electric Cooperative Corporation (“Salt River”) and Shaker Landing Hydro Associates, Inc. (“Shaker Landing Hydro”) are the sole members of Lock 7 Partners and hold an equal interest in the company.

Salt River, a rural electric cooperative organized pursuant to KRS Chapter 279, owns and operates facilities used for the transmission and distribution of electricity to the public for compensation. It serves approximately 42,235 customers in Nelson, Spencer, Bullitt, Washington, Marion, Mercer, Shelby, Anderson, Jefferson and Larue counties, Kentucky.⁴ It is a utility subject to Commission jurisdiction and a retail electric supplier.⁵

Shaker Landing Hydro is a Kentucky corporation organized pursuant to KRS Chapter 271B. It is owned and operated by three principal partners of Soft Energy Associates, a firm involved in the development of renewable energy and with experience in the operation of hydroelectric plants in Kentucky and other states.

² Kentucky Public Service Commission Supplement to Kentucky Utilities Company, FERC Form 1 (Mar. 31, 2004) at 1 – 2.

³ KRS 278.010(3)(a); KRS 278.010(4); KRS 278.040(1).

⁴ Annual Report of Salt River Electric Cooperative Corporation to the Public Service Commission of Kentucky for the year ended December 31, 2004 at 17 and 19.

⁵ KRS 278.010(3)(a); KRS 278.010(4); KRS 278.040(1); KRS 279.210.

STATEMENT OF THE CASE

The Lock No. 7 Project is a 2.04-megawatt generating plant that is located on the Kentucky River in Mercer County, Kentucky. It was constructed in 1927 and began commercial operation in 1928. It uses surplus water from Kentucky River Lock and Dam No. 7 to generate electricity. KU acquired its interest in the Lock No. 7 Project from Kentucky Hydro Electric Company on December 31, 1928. The Lock No. 7 Project represents approximately 0.04 percent of KU's current installed generation.⁶

Since the early 1990s, KU has investigated the condition and future operation of the Lock No. 7 Project.⁷ It commissioned a "Conceptual Budget Report" on the costs of decommissioning the Lock No. 7 Project. The preparer of this report, 3-D Enterprises Construction Management Corp., estimated the cost of decommissioning between \$2.7 million and \$20.6 million.⁸

In March 2002, Duke Engineering & Services ("Duke Engineering") prepared a more detailed report on the current state of the Lock No. 7 Project and the possible

⁶ KU currently has 4,997 megawatts of installed generation. See Kentucky Utilities Company, FERC Form 1 (Mar. 31, 2004) at 402 – 410. The Commission recently issued a Certificate of Public Convenience and Necessity to KU and Louisville Gas and Electric Company to construct a 750-megawatt super-critical pulverized coal base load unit. KU will own approximately 456 megawatts of this unit. See Case No. 2004-00507, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity, and a Site Compatibility Certificate, for the Expansion of the Trimble County Generating Station (Ky.PSC Nov. 1, 2005).

⁷ KU's Response to First Data Request of Commission Staff, Item 4.

⁸ Duke Engineering and Services, Lock No. 7: Initial Investigation Report (Mar. 18, 2002) at 28.

surrender of KU's Federal Energy Regulatory Commission ("FERC") license to operate the hydro station. It reviewed the following options:⁹

1. Transfer the license and plant to another operator.
2. Surrender the license, remove the generation equipment and transfer the property to the Kentucky River Authority ("KRA").
3. Surrender the license, remove the generation equipment, remove the hydro station to the waterline and transfer the property to KRA.
4. Repair one unit.
5. Do nothing.
6. Repair two or more of the hydro stations units.

Duke Engineering found that the most economical option was to transfer the license and plant to another operator and the second most economic option was to decommission the plant. It found that all of the rehabilitation alternatives had a negative net present value and that, given their high capital costs as compared to the other options, should not be pursued. It recommended the transfer of the license and the plant to another operator as the most preferable option.¹⁰

In August 2002, FERC inspectors conducted an operation inspection of the Lock No. 7 Project. Among their findings, these inspectors noted that the generator/turbines

⁹ Id. at 1 – 3.

¹⁰ Id. at 24 – 25.

appeared to be poorly maintained and had not generated any power for almost 2 years. They recommended that the plant be brought back on-line or decommissioned.¹¹

By May 2002, KU had determined that continued operation of the Lock No. 7 Project was not economically feasible.¹² It elected to pursue a course of action that would permit KU to surrender the FERC license to operate the Lock No. 7 Project or sell the Lock No. 7 Project to a third party and transfer its FERC license to that third party. KU executed a contract with Synergics, Inc. (“Synergics”) to permit it to perform its own evaluation of the Lock No. 7 Project. After more than a year of evaluations and negotiations, Synergics notified KU that it was not interested in purchasing the Lock No. 7 Project and terminated negotiations.¹³

On June 30, 2003, KU notified FERC that it expected to surrender its license for the Lock No. 7 Project.¹⁴ On April 1, 2004, KU submitted to FERC its “Initial Consultation Document in Support of Application for License Surrender For the Lock No. 7 Hydroelectric Project.” In this document, KU stated that, after a thorough

¹¹ Letter from Peggy A. Harding, Engineer, FERC Office of Energy Projects, Division of Dam Safety and Inspections, to Howard Bush, Manager, LG&E Regulatory Compliance, Rates and Regulatory Department (Dec. 18, 2002).

¹² Kentucky Utilities Company, Initial Consultation Document in Support of Application for License Surrender For Lock No. 7 Hydroelectric Project (FERC No. 539) (April 1, 2004) at I-2.

¹³ Case No. 2003-00434, An Adjustment of the Electric Rates, Terms and Conditions of Kentucky Utilities Company, KU’s Response to the Supplemental Data Request of the Attorney General, Item A-1.

¹⁴ Letter from Michael S. Beer, Vice President for Rates and Regulatory, LG&E Energy, to Peggy A. Harding, Regional Director, Chicago Regional Officer, (June 30, 2003).

assessment of the Lock No. 7 Project, it had determined that continued operation of the Lock No. 7 Project was not financially viable.¹⁵

On April 19, 2004, KU and Soft Energy entered into a due diligence agreement to allow Soft Energy to investigate the feasibility of Soft Energy rehabilitating the Lock No. 7 Project. Soft Energy subsequently incorporated Shaker Landing Hydro and a separate company to pursue the acquisition, renovation and operation of the Lock No. 7 Project. Shaker Landing Hydro and Salt River subsequently formed Lock 7 Hydro Partners, LLC with a view toward acquiring, renovating and operating the Lock No. 7 Project.

On September 26, 2005, KU and Lock 7 Partners executed an Asset Purchase Agreement (“Agreement”) that provides for the transfer of all assets of the Lock No. 7 Project to Lock 7 Partners. Under the Agreement’s terms, KU will, by quitclaim deed, transfer its interest in any real property associated with the Lock No. 7 Project to Lock 7 Partners for \$35,965.

On September 27, 2005, KU and Lock 7 Partners applied to FERC for approval to transfer the license to the Lock No. 7 Project. On November 23, 2005, FERC approved the application.¹⁶

DISCUSSION

In its review of KU’s options for managing the Lock No. 7 Project, Duke Engineering noted that KU’s transfer of the license to another plant operator was the

¹⁵ Kentucky Utilities Company, Initial Consultation Document in Support of Application for License Surrender For Lock No. 7 Hydroelectric Project (FERC No. 539) (April 1, 2004) at I-2.

¹⁶ Kentucky Utilities Company, 113 FERC ¶ 62,150 (Nov. 23, 2005).

least costly and preferred option. It noted, however, that KU was unlikely to find a qualified buyer and the likelihood of selling the Lock No. 7 Project to a party who would meet with FERC's approval was low.¹⁷ KU's proposed transaction with Lock 7 Hydro allows it to achieve the least costly course of action for the utility and for its ratepayers. The proposed transaction allows KU to avoid the significant costs of decommissioning the Lock No. 7 Project. The transfer of the hydrostation will have a relatively insignificant effect on KU's total generation capacity.

SUMMARY

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. No power generation has occurred at the Lock No. 7 Project since 1999.
2. The transfer of the license and any property or rights associated with the Lock No. 7 Project to a qualified operator is the least cost and preferred option for KU.
3. Without the transfer of the license, FERC would have required KU to either rehabilitate the Lock No. 7 Project and bring the plant back on-line or decommission the facility.
4. By transferring the license and any property associated with the Lock No. 7 Project, KU will avoid significant decommissioning costs.
5. FERC has approved the transfer of the license from KU to the Lock 7 Partners.
6. The Lock No. 7 Project currently represents approximately 0.04 percent of KU's current installed generation and will represent less than 0.038 percent after

¹⁷ Duke Engineering and Services at 1.

completion of the Trimble County Unit No. 2. The proposed transfer will not significantly affect KU's operations or the quality or reliability of its service to the public.

IT IS THEREFORE ORDERED that KU's application for authority to transfer any real property associated with the Lock No. 7 Project to Lock 7 Partners is granted.

Done at Frankfort, Kentucky, this 22nd day of December, 2005.

By the Commission

ATTEST:


Executive Director